

**Add Section 115.1 to the Evidence Code to state that the burden of proving the existence of fraud or intent to evade for the purpose of imposing a penalty on any tax or fee pursuant to the Revenue and Taxation Code requires clear and convincing evidence.**

**Source: Business Taxes Committee**

Section 115 of the Evidence Code states, "except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence." The burden of proof to establish fraud or intent to evade the tax is on the Board of Equalization (Board). (*Marchica v. State Bd. of Equalization* (1951) 107 Cal.App. 2d 501.) Since there is no other statutory standard of proof to establish fraud or intent to evade for purposes of the Sales and Use Tax Law, under Evidence Code Section 115 the Board must establish fraud or intent to evade the tax by a preponderance of the evidence. (*Liodas v. Sahadi* (1977) 19 Cal.3d 278.)

When the Franchise Tax Board (FTB) asserts fraud against a taxpayer, the FTB also must carry the burden of proof. However, the FTB must establish fraud by clear and convincing evidence. (See *Appeal of Juan F. and Elizabeth M. Lopez*, Cal. St. Bd. of Equal. (5/4/83); *Appeal of Gary D. Armstrong*, Cal. St. Bd. of Equal. (12/3/85).) The standard of proof by a preponderance of the evidence set forth in Evidence Code Section 115 does not apply to the FTB's assertion of fraud because Revenue and Taxation Code Section 19164 requires that the imposition of a fraud penalty by the FTB be determined in accordance with the provisions of Section 6663 of the Internal Revenue Code. Since, for purposes of Internal Revenue Code Section 6663, the government must carry its standard of proof by clear and convincing evidence, the same standard of proof by clear and convincing evidence must be satisfied by the FTB to establish fraud under Revenue and Taxation Code Section 19164.

Revenue and Taxation Code Section 19164 requires one standard of proof for FTB fraud cases, but Evidence Code Section 115 sets forth a different standard of proof that applies to other tax fraud matters. In order to obtain conformity in the standard of proof for imposition of fraud, penalties imposed under all tax programs included in the Revenue and Taxation Code as well as with the federal standard of proof in fraud cases, the Evidence Code should be amended to raise the standard of proof to clear and convincing evidence for the imposition of fraud penalties in tax matters. Accordingly, this proposal would require the State to establish fraud by clear and convincing evidence for all tax programs included in the Revenue and Taxation Code. This standard would apply to all administrative and court actions in which the State asserts a penalty set forth in the Revenue and Taxation Code based on fraud or intent to evade tax, or the State's defense of such a penalty.

## Background

A “preponderance of the evidence” simply requires the trier of fact to believe that the existence of a fact is more probable than its nonexistence before finding in favor of the party who has the burden of proof. (*In re Angelia P.* (1981) 28 Cal.3d 908, 918.) “Clear and convincing evidence” requires a finding of high probability; the evidence must be so clear as to leave no substantial doubt. (*Id.* at 919.) However, clear and convincing evidence is *not* evidence beyond a reasonable doubt. Evidence of a charge is clear and convincing so long as there is a “high probability” that the charge is true. The evidence need not establish the fact beyond a reasonable doubt. (*Broadman v. Commission on Judicial Performance* (1998) 18 Cal.4<sup>th</sup> 1079, 1090.)

State excise tax matters as well as State income tax matters are reviewed by the California courts on a de novo basis. In other words, taxpayers are entitled to a full evidentiary hearing on the merits of their claims and the tax agency bears the burden of establishing fraud in accordance with law as set forth in the statutes and in the decisions of the California courts. In a de novo proceeding, all issues of fact and law that were presented to the administrative agency are considered anew by the court, regardless of the holding by the administrative agency, and the court will apply the standard of proof in accordance with law. Accordingly, if litigation involves a fraud penalty imposed under the Sales and Use Tax Law, the court will require the Board to establish that fraud by a preponderance of the evidence.

It is appropriate that the standards be the same at both the administrative and judicial levels. Therefore, the Evidence Code is the appropriate code in which to make the change. For example, suppose the Board were to maintain a clear and convincing standard of proof for its sales tax cases and the Board is convinced at an oral hearing that there is clear and convincing evidence of fraud. The taxpayer thereafter files a suit for refund. If in the court’s opinion the Board is unable to establish fraud by clear and convincing evidence, the court would nevertheless uphold the fraud penalty if the Board were able to establish the fraud by a preponderance of the evidence. Under this proposal, the court would also use the clear and convincing standard of proof.

*Section 115.1 of the Evidence Code is added to read:*

115.1. The existence of fraud or intent to evade must be proven by clear and convincing evidence for purposes of imposing a fraud or intent to evade penalty under the Revenue and Taxation Code.